

MSCI ESG Ratings Methodology: Supply Chain Labor Standards Key Issue

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Introduction

This document provides essential information on the components of the Supply Chain Labor Standards Key Issue to enable users of ESG Ratings to understand how our outputs are determined. Supply Chain Labor Standards is a Key Issue in the Social Pillar of the MSCI ESG Ratings model. Companies are evaluated on the management and transparency of their supply chain and the working standards in the regions in which their suppliers are located.

For additional details on the MSCI ESG Ratings Model, refer to Section 2, Data, ratings and scores, of “ESG Ratings Methodology.”

Exhibit 1: MSCI ESG Key Issue hierarchy

3 Pillars	10 Themes	33 ESG Key Issues
Environmental	Climate Change	Carbon Emissions
		Climate Change Vulnerability
		Financing Environmental Impact
		Product Carbon Footprint
	Natural Capital	Biodiversity & Land Use
		Raw Material Sourcing
		Water Stress
	Pollution & Waste	Electronic Waste
		Packaging Material & Waste
		Toxic Emissions & Waste
	Environmental Opportunities	Opportunities in Clean Tech
		Opportunities in Green Building
		Opportunities in Renewable Energy
Social	Human Capital	Health & Safety
		Human Capital Development
		Labor Management
		Supply Chain Labor Standards
	Product Liability	Chemical Safety
		Consumer Financial Protection
		Privacy & Data Security
		Product Safety & Quality
		Responsible Investment
	Stakeholder Opposition	Community Relations
		Controversial Sourcing
	Social Opportunities	Access to Finance
		Access to Health Care
Opportunities in Nutrition & Health		
Governance	Corporate Governance	Board
		Pay

3 Pillars	10 Themes	33 ESG Key Issues
		Ownership & Control
		Accounting
	Corporate Behavior	Business Ethics
		Tax Transparency

Risks associated with this Key Issue

- Production delays due to labor unrest in supply chains.
- Reduced productivity and product quality.
- Loss of growth opportunities, market share or pricing power due to negative publicity and damage to brand value.

Supply Chain Labor Standards Key Issue Score

The Supply Chain Labor Standards Key Issue Score evaluates the company’s level of exposure to, and management of, risks on this Key Issue. The Key Issue Score is based on the Exposure Score and the Management Score using the formula below. The Exposure Score and the Management Score are combined such that a higher level of exposure requires a higher level of demonstrated management capability in order to achieve the same overall Key Issue Score.

$$KI_i = 7 - (\max(EXP_i, 2) - MGMT_i)$$

Where:

- KI_i is the Key Issue Score for company i .
- EXP_i is the Exposure Score for company i .
- $MGMT_i$ is the Management Score for company i .

Supply Chain Labor Standards Management Score

The Supply Chain Labor Standards Management Score evaluates the company’s ability to manage its exposure to risks on this Key Issue. It is based on the Management Score category listed below, modified by Controversies. These scores are derived from data points that are scored on a 0-10 scale, with 10 corresponding

to best practice and 0 corresponding to lack of management. Refer to Section 3.3, Analyzing risk management, of “ESG Ratings Methodology” for additional details. Sources are company disclosures except where otherwise indicated. The following formula is used to calculate the Supply Chain Labor Standards Management Score - Excluding Controversies:

$$MGMT_{SLS,i} = PRA_{SLS,i}$$

Where:

- $MGMT_{SLS,i}$ is the Supply Chain Labor Standards Management Score - Excluding Controversies for company i .
- $PRA_{SLS,i}$ is the Practices Score for company i .

The following data points, without constituting an exhaustive list, are representative of the inputs to the Management Score and are used in the Management Score calculation:

Management Score category: Practices Score

- **Supply chain code of conduct covers anti-discrimination.**
Definition: Indicates whether the company’s supply chain code of conduct sets forth requirements forbidding suppliers from engaging in discrimination with regard to their employees.
- **Supply chain code of conduct covers child labor.**
Definition: Indicates whether the company’s supply chain code of conduct forbids suppliers to use underage labor.
- **Supply chain code of conduct covers forced labor.**
Definition: Indicates whether the company’s supply chain code of conduct forbids suppliers to use forced labor.
- **Supply chain code of conduct covers freedom of association.**
Definition: Indicates whether the company’s supply chain code of conduct sets forth requirements that suppliers respect freedom of association and allow workers to unionize if desired.

- **Supply chain code of conduct covers health and safety.**

Definition: Indicates whether the company’s supply chain code of conduct sets forth requirements regarding health and safety working conditions at supplier factories.

- **Supply chain code of conduct covers minimum wage.**

Definition: Indicates whether the company’s supply chain code of conduct sets forth requirements regarding the minimum wages that suppliers must pay their employees.

- **Supply chain code of conduct covers paid overtime.**

Definition: Indicates whether the company’s supply chain code of conduct sets forth requirements that suppliers pay overtime wages when employees must work overtime hours.

- **Supply chain code of conduct covers working hours.**

Definition: Indicates whether the company’s supply chain code of conduct sets forth requirements limiting the amount of hours suppliers’ employees may be required to work in a day or a week.

- **Training of suppliers on labor-related social issues.**

Definition: Indicates whether the company has specific training programs in place with its suppliers on its supplier code of conduct or specific labor-related issues.

- **Supplier selection based on labor management performance.**

Definition: Indicates whether the company considers suppliers’ performance in allocating or renewing contracts, and/or placing further orders.

- **Scope of supplier audits.**

Definition: Indicates whether the company conducts internal and/or external audits across its supply chain.

- **Action taken to address supplier misconduct.**

Definition: Indicates whether the company provides evidence of developing a remediation action plan when incidents of noncompliance with its code of conduct are found.

- **Extent of disclosure on instances of supplier misconduct.**

Definition: Indicates whether the company discloses the frequency and type of noncompliance incidents found in its supply chain.

- **Tier 1 supplier audits (direct suppliers).**

Definition: Indicates whether some or all Tier 1 suppliers (i.e., direct suppliers) are covered by the social audit program of the company.

- **Tier 2 suppliers audits (components).**

Definition: Indicates whether some or all Tier 2 suppliers (i.e., components) are covered by the social audit program of the company.

- **Tier 3 suppliers audits (raw materials).**

Definition: Indicates whether some or all Tier 3 suppliers (i.e., raw materials) are covered by the social audit program of the company.

Sources: company disclosures, International Labour Organization.

Controversies

A controversy deduction ranging from 0 to 5 points is subtracted from the overall Management Score, based on the severity and type of controversies facing the company on this Key Issue. The following categories of controversies are used in the assessment:

- Supply chain labor standards controversies.

For more details on how controversies are included in the MSCI ESG Ratings model, refer to Section 3.3.2, Controversies cases, of “ESG Ratings Methodology.”

Supply Chain Labor Standards Exposure Score

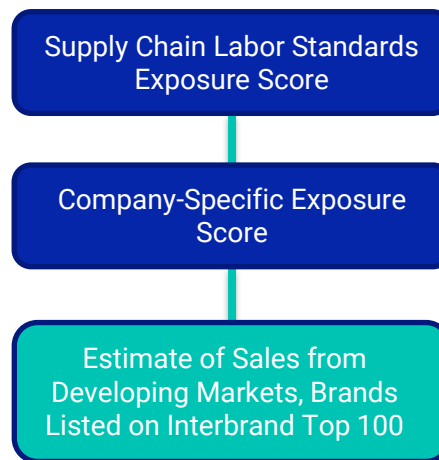
The Supply Chain Labor Standards Exposure Score evaluates the company’s exposure to risks on this Key Issue. It is based on the Company-Specific Exposure Score only. The Company-Specific Exposure Score is scored on a 0-10 scale, with 10 corresponding to the highest risk and 0 corresponding to the lowest risk. Refer to Section 3.2, Analyzing risk exposure, of “ESG Ratings Methodology” for additional details. The following data sources and methodologies are used in the Exposure Score calculation:

$$EXP_{SLS,i} = COM_{SLS,i}$$

Where:

- $EXP_{SLS,i}$ is the Supply Chain Labor Standards Exposure Score of company i .
- $COM_{SLS,i}$ is the Company-Specific Exposure Score of company i .

Exhibit 2: Exposure Score components



Company-Specific Exposure Score

The Company-Specific Exposure Score is a simple average of the Brand Recognition Score and the Footprint Score:

$$COM_{SLS,i} = \frac{BRS_{SLS,i} + FS_{SLS,i}}{2}$$

Where:

- $BRS_{SLS,i}$ is the Brand Recognition Score for company i .
- $FS_{SLS,i}$ is the Footprint Score for company i .

A Brand Recognition Score of 10 is assessed for companies that get featured on Interbrand’s Top 100 Best Global Brands List. Companies that do not feature on this list get a score of 0.

The Footprint Score is calculated using total estimated revenues from products manufactured in developing and frontier markets.¹

Data Sources

The following sources are used to determine the Supply Chain Labor Standards Exposure Score:

Refinitiv, MSCI ESG Research, company disclosures, Interbrand.

¹ Companies are assessed on revenues from their private-label products where applicable.

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